



## MEMORANDUM

**TO:** Mayor and Council

**FROM:**  Lauraine Rizer, Officer, Office of Real Estate Services

**DATE:** November 20, 2017

**SUBJECT:** Health South Property

The Health South building located at 1215 Red River street was purchased on February 28, 2017. City Council Resolution No.20170323-052 directed staff to evaluate the Health South building for its potential to provide affordable housing at 60% median family income or below for individuals as well as families.

Economic & Planning Systems, Inc. (EPS) was hired to evaluate options including costs and time frame for maintaining the existing room configuration, substantially reconfiguring the space or a mixture of both. Additionally, EPS looked at whether the City should consider lease/sale of the property. The number of residential units with reconfiguration is 54 at a cost of \$327,692 per unit or a total of \$17,696,365. The number of residential units without reconfiguration is 41 at a cost of \$344,066 per unit or a total of \$14,106,703. EPS found listings for 13 apartment properties at an average asking price of \$158,104 per unit. Austin Housing Finance Corporation provided EPS budgets for nine new construction projects at an average development cost of \$180,847 per unit.

EPS recommends that the City explore the sale or lease of the building as-is and coordinate with Central Health regarding the site's potential contribution to overall redevelopment of the adjacent University Medical Center Brackenridge campus.

Attached is a copy of the Economic & Planning Systems, Inc. (EPS) report for your review. Please feel free to contact me at 512-974-7078 if you have any questions.

cc: Elaine Hart, Interim City Manager  
Sara Hensley, Interim Assistant City Manager  
Greg Canally, Interim Chief Financial Officer  
Eric Stockton, Building Services Officer

## **MEMORANDUM**

To: Lauraine Rizer, City of Austin  
From: Darin Smith  
Date: August 21, 2017  
Subject: Economic Analysis of HealthSouth Property Reuse as Housing; EPS #171066

Economic & Planning Systems (EPS) has been retained to assist the City of Austin in evaluating the feasibility of re-using the HealthSouth property. The City recently acquired the HealthSouth building, and City Council has expressed interest in exploring the potential reuse of the building for mixed-income housing or other uses. City Council Resolution No. 20170323-052 has directed staff to:

- Evaluate the HealthSouth building for its potential to provide affordable housing in the range of 60% median family income or below, as well as some market rate housing for individuals and families. The evaluation should consider options for:
  - maintaining the existing room configuration;
  - substantially reconfiguring the space; or
  - embarking on a mixture of the two approaches.
- Estimate the general costs and minimum timetable for achieving these options and identify potential funding strategies for doing so.
- Identify potential private entities that could partner on developing the housing component.
- Provide general information about the square footage that could be rented to nonprofit or other organizations if the building is primarily reserved for housing.
- Recommend whether the City should consider renting out space in the near term, while also evaluating longer-term possibilities for HealthSouth.
- Sketch out some next steps and a potential timetable in the circumstance that Council chooses to move forward with a more detailed analysis and/or implementation of a concept that includes the elements described in this resolution.

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## Summary of Findings

In this document, EPS has addressed the general feasibility questions posed by the City Council Resolution. As described below, EPS has reached the following findings:

- 1. The HealthSouth building would be highly inefficient to reuse for housing without a major reconfiguration of both the interior and exterior of the building.** EPS estimates that the existing floorplans might allow the creation of 41 very small studios or micro-units in the existing patient rooms (averaging roughly 312 square feet), but these would utilize less than 20 percent of the potential floor area. A major reconfiguration of interior walls, new windows, and other features could yield more than double the amount of usable residential space and create an estimated 54 units of different sizes (averaging over 600 square feet) that are more appealing to tenants.
- 2. The costs to renovate the HealthSouth Building for housing are expected to be substantial, and are estimated to cost more per usable square foot without reconfiguration than with reconfiguration.** Based on a nearby case study exploring the potential reuse of a similar medical building for residential and office uses, EPS estimates that the cost to significantly reconfigure and renovate the HealthSouth building would be roughly \$18.9 million. Even without significant reconfiguration of interior and exterior walls, EPS projects that the costs of renovation for residential use would be at least \$8.0 million. Adding these costs to the property purchase price of \$6.5 million paid by the City, the total capital costs for building acquisition and renovation are estimated at \$14.5 million to \$25.4 million. The cost per usable square foot is estimated to be substantially higher without interior reconfiguration than with reconfiguration, because more than three times as much space is believed to be usable with major reconfiguration.
- 3. The value of residential units – whether at market rate or priced for households earning 60 percent of median family income – are expected to fall well below the costs of creating those units.** Based on the costs of acquisition, rehabilitation, and operations, EPS estimates that the rent required for feasibility without subsidy would exceed \$2,400 per month under either reconfiguration scenario. By contrast, market-rate rents are expected to be nearer \$1,300 per month for the units at 620 square feet (under the major reconfiguration scenario) and only \$858 for the 312-square-foot units without major reconfiguration. By City standards, a one-person household earning 60 percent of median family income in 2017 can pay \$798 per month for rent, which also falls well below the feasibility threshold without subsidy.
- 4. The inclusion of commercial space in the HealthSouth building may be a net detractor from the feasibility of its reuse.** City Council has inquired about the potential to offer some space to commercial tenants, especially non-profits. While this is physically possible, particularly on the first floor with some major reconfiguration, EPS estimates that the cost of providing such space would require significant subsidy, even if such tenants could pay full market-rate office rents. As such, the entire building's feasibility for reuse would only worsen with the commercial component, as the housing component and commercial component both require significant subsidy. An exception to this conclusion may result if the City were able to secure a medical-related tenant who could make use of the building mostly "as-is," thus avoiding costly renovation efforts.

5. **At least twice as many units likely could be provided elsewhere in Austin for the cost to subsidize housing in the HealthSouth building.** A review of recent new construction projects indicates that the average cost to develop a new affordable unit is roughly half of the amounts estimated for the HealthSouth building, and these new units typically serve households much larger than could be accommodated through renovation at HealthSouth. Similarly, recent projects to acquire and rehab existing apartment complexes have cost far less per unit than is estimated for HealthSouth, and current property listings indicate that numerous existing apartment properties could be acquired and designated as permanent affordable housing at roughly half the cost per unit as is projected for HealthSouth.
  
6. **The sale or lease of the HealthSouth buildings, or even the sale of the site for future development, are expected to yield much greater revenues that could be used for affordable housing or other City objectives.** The appraisals for the HealthSouth properties indicate that the City could realize roughly \$10 million to \$30 million in net revenues from the HealthSouth transaction by selling the building as-is, leasing the building to a specifically interested user group, or offering the site for future development. Based on recent City funding for affordable housing, and assuming the leveraging of other external funding sources as is typical of affordable housing projects, this level of revenue could be used to create roughly 500 to 1,500 affordable units throughout the City, compared to only about 54 that might be created within the building itself – assuming additional funding can be secured to subsidize those 54 units. Based on these comparisons, EPS does not believe that the reuse of the HealthSouth building for housing represents an efficient use of the City's resources. Rather, EPS recommends that the City explore the sale or leasing of the building as-is and/or coordination with Central Health regarding the site's potential contribution to and benefit from the overall redevelopment of the adjacent University Medical Center Brackenridge campus.

Pending discussion of these feasibility findings, EPS has not pursued the issues of potential partners for the building's reuse, nor identified potential funding sources for such reuse.

## **Approach to the Assignment**

EPS has been asked to assess whether it is feasible to reuse the HealthSouth building for residential and possibly commercial office space. EPS is generally familiar with the HealthSouth property, and for this analysis, EPS has reviewed various documents provided by the City (appraisals, environmental studies, site plans, photographs, etc.) for the most expeditiously available and reliable information regarding the building's interior conditions. EPS is also familiar with the expected costs to renovate medical facilities for non-medical use, having participated in a study of a similar opportunity in the Austin area in the past three years. As described below, EPS has relied on information from that other study as indicative of the expected costs to renovate the HealthSouth building. EPS is also familiar with the City's affordable housing expectations and practices, having contributed to numerous City studies for subjects including density bonus programs, Homestead Preservation Districts, and negotiations with private and non-profit developers regarding affordable housing requirements and funding. Finally, EPS is familiar with market conditions in Downtown Austin, having conducted numerous studies for the City over the past 15 years regarding downtown development. EPS has refreshed this local market knowledge as appropriate with surveys of current rents as necessary for this study.

Despite this extensive familiarity with various aspects of this analysis, it remains a “planning level” assessment of the feasibility issues. EPS is not a structural engineering or architectural firm, and thus is reliant on our general knowledge of adaptive reuse issues, residential building design, and related factors for this assessment. If City Council wishes to explore this matter further, EPS recommends retaining more specialized firms who can provide engineering, design, and cost estimating expertise specific to this building.

This analysis further assumes that conversion of the existing medical facility to residential and/or general commercial use would be possible and relatively simple. EPS has not explored the implications of such conversion in terms of zoning or other use permits, and such issues would need to be addressed as part of any further consideration of this potential conversion.

## General Property Overview

The HealthSouth building is located at 1215 Red River Street and offers 89,746 square feet of medical and office space on four floors.<sup>1</sup> In addition, the property includes a two-level parking structure offering 62 spaces, which fronts and is accessed by East 12<sup>th</sup> Street. The building being considered for reuse does not offer great accessibility or visibility from the City street grid, as it is tucked behind the parking structure within a multi-block campus area, but is near the Capitol Complex and the University of Texas main campus and new medical school and hospital, and is a few short blocks from Interstate 35.

The HealthSouth building is immediately south of the University Medical Center Brackenridge (UMCB) campus, a six-block area owned by Central Health and slated for redevelopment in future years. Though not yet entitled by the City of Austin, Central Health’s plans for UMCB involve soliciting and partnering with a Master Developer to develop a coordinated, mixed-use, multi-block, high density project similar in scale to the Green Water Treatment Plant project on Second Street. As such, the four-story HealthSouth building is much lower density than the development currently envisioned on adjacent parcels.

The Phase 1 Environmental Assessment Report prepared by Terracon in November 2016 did not indicate any significant issues with building conditions, systems, environmental contamination, or related factors. With this information being the most recent and complete available, and knowing that the building was in use until the recent past, EPS assumes that the reuse of the building would not face any major unexpected costs.

**Figure 1** shows the existing floorplan of the first (ground) floor of the HealthSouth building. As shown, less than half of the exterior perimeter on this floor has windows (shown in blue). The bulk of this first floor was used for utility and storage areas, plus vertical access for stairs and elevators. Other features of the first floor include an industrial kitchen and dining area, a small gymnasium and pool for therapy activities, and various rooms and offices for patient treatment and administrative functions. The great majority of this floor is more than 20 feet from the nearest window, making it highly unappealing as residential space without a major re-configuration of both interior space and the building’s exterior.

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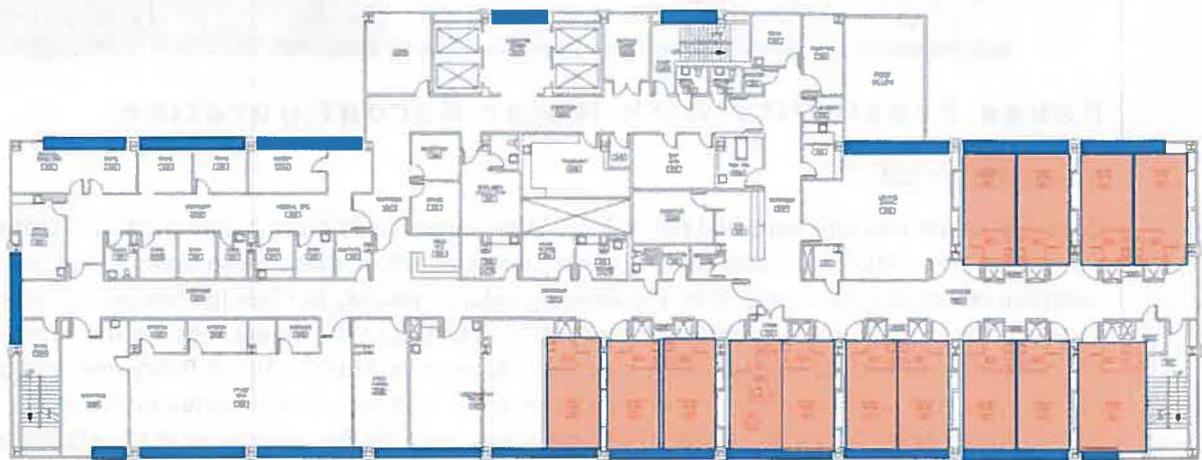
<sup>1</sup> Source: Terracon Phase 1 Environmental Site Assessment, November 28, 2016, page 20

**Figure 1 Existing First Floor Layout of HealthSouth Building**

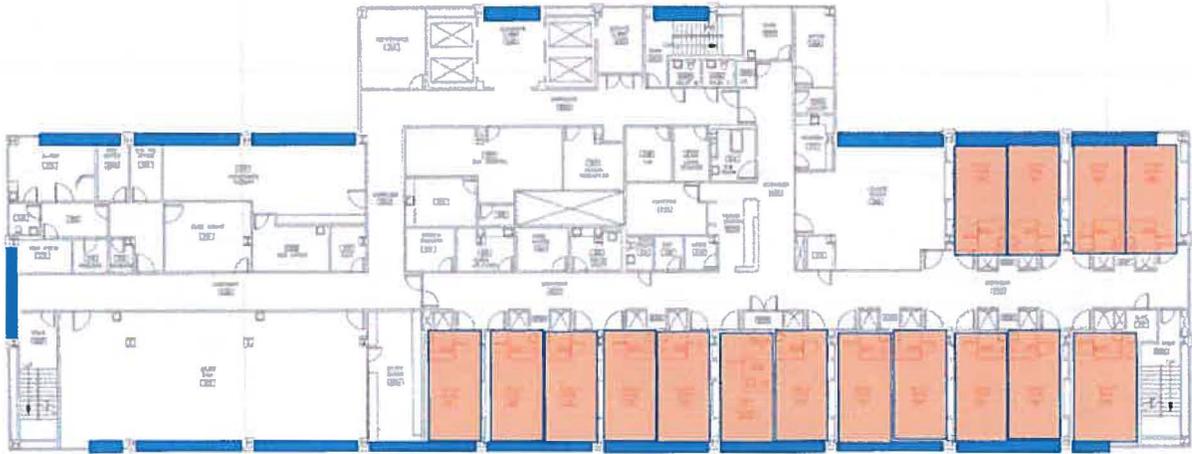


**Figures 2 through 4** show the existing floorplan for the second through fourth floor of the building. The 41 total patient rooms were located on these three upper floors (shown in orange), with each room measuring roughly 12 by 26 feet (312 square feet) including a basic bathroom with a sink, shower, and toilet. These three floors have regular column spacing that determines the room sizes, and the patient rooms are all located on each floor's southeastern end while the western end is used for therapeutic spaces, examination rooms, and administrative functions. The northern edge of the building is again used mostly for utilities and vertical circulation. While windows are more plentiful than on the first floor, the interior of each upper floor – roughly a third of each floor's total area – does not have window access and thus is unlikely to be usable as residential space.

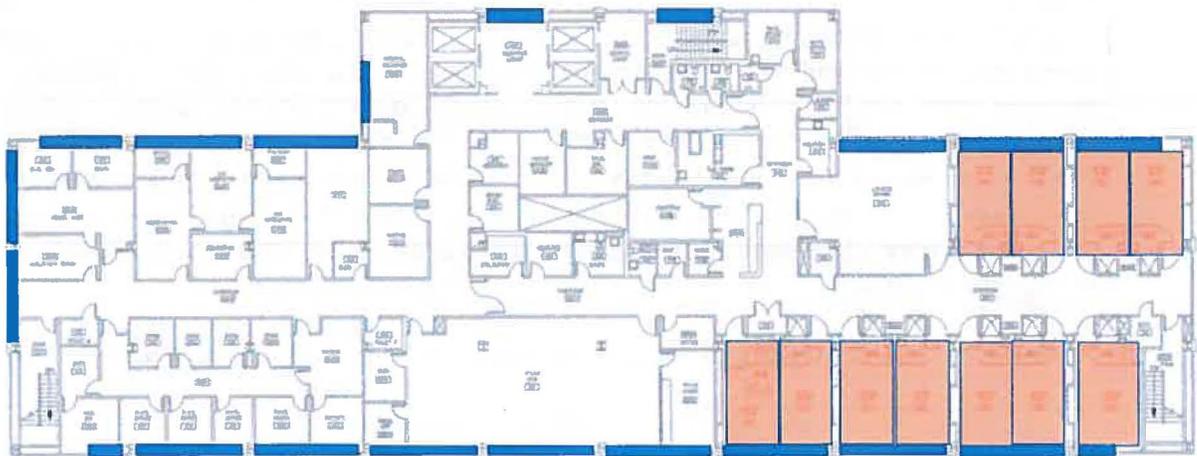
**Figure 2 Existing Second Floor Layout with Patient Rooms Highlighted**



**Figure 3 Existing Third Floor Layout with Patient Rooms Highlighted**



**Figure 4 Existing Fourth Floor Layout with Patient Rooms Highlighted**



## **Reuse Feasibility with Major Reconfiguration**

### **Reuse Potential**

**Figure 5** illustrates one potential floorplan for the upper floors if the building interior underwent significant reconfiguration (and could apply equally to each of those three floors). The new floorplan would still be centered on the existing column widths, but would remove the walls between the existing patient rooms to create units closer to 620 square feet – a more typical size for small one-bedrooms or even large studios in downtown Austin. These floorplans would also make use of the western ends of each floor, currently built for administrative or therapeutic activities rather than patient rooms. In some areas, such as the corners near the stairwells and elevators, units would be smaller and/or have a less regular shape, or these units' square footage could be combined with adjacent units to create two or three-bedroom units. To achieve these configurations, new windows would need to be added in some areas on each floor, and plumbing and exterior ventilation would need to be reconfigured to adjust existing bathrooms and create new kitchens.

**Figure 5 Potential Upper Floor Residential Space after Major Reconfiguration**



By comparison to the floorplans *without* interior reconfiguration (to be discussed below), these reconfigured floorplans make much more efficient use of the building square footage, as EPS estimates that the equivalent of 18 units averaging 620 square feet could be created on each upper floor, representing just over 50 percent of the total square footage of each floor. This would be far less efficient than a typical new multifamily building and would leave a significant area of the interior of each floor unusable for residential space due to distances from windows, but that area might be amenitized as common space for tenants.

The first floor also offers opportunities for amenities for the residents. The existing swimming pool and gymnasium areas on the western end of the first floor could potentially be retained and reused, and the small office spaces on that western end reconfigured for a lobby and other community space. On the eastern end, EPS believes that reuse for residential space would be challenging due to the profound lack of windows, surplus of exterior doors, etc. However, this eastern end of the first floor might be usable for commercial space, if significantly reconfigured. **Figure 6** demonstrates how this first floor might be divided between commercial office space (shown in red) and lobby/amenity space (shown in yellow) for the residential units on the upper floors. EPS estimates that roughly 10,000 square feet of ground floor commercial space could result from this configuration, though it too would benefit greatly from new exterior windows.

**Figure 6 Potential Ground Floor Space after Major Reconfiguration**



## **Estimated Reuse Costs**

For the past few years, EPS has been working on another Austin-area redevelopment project which explored, among other things, the potential reuse of an existing medical building for residential and commercial uses. The building in question has a floorplate of roughly 23,000 square feet in a long, rectangular configuration, similar to the HealthSouth building. Structural engineers and contractor-level consultants prepared cost estimates for the reconfiguration of existing patient rooms into units averaging roughly 600 square feet, which involved removing walls, adding plumbing and ventilation, and modest improvement of building exteriors. Once reconfigured, the case study building was estimated to yield roughly 50 percent of its floorplates as rentable residential space, similar to EPS's estimate for the reconfigured HealthSouth building. These characteristics make EPS's previous experience highly relevant to what might be accomplished through the reconfiguration and reuse of the HealthSouth building for housing.

In 2014, the cost estimators for the case study determined that the reuse costs would sum to \$166 per square foot. According to RS Means, an industry standard cost estimating and tracking resource, the cost of construction in Austin has increased by roughly 20 percent since late 2014. This factor would suggest that the 2017 construction cost would be nearer \$199 per square foot. This figure does not reflect prevailing wage or union labor which, according to RS Means, adds roughly 8 percent to typical construction costs. Based on these adjustments, EPS estimates that the current cost of renovating the case study building for residential use would be \$215 per square foot. Given the similarities between the two buildings in their location, configuration, previous use, and potential use, EPS believes this figure is a reasonable proxy for planning-level feasibility analysis for the HealthSouth building. This figure may actually be aggressive (i.e., low) for the HealthSouth building because the case study building did not require the installation of numerous windows to achieve optimal buildout. Interestingly, the case study examined the potential reuse of the other building for office, and determined that office use would cost roughly 8 percent more than residential (\$179 vs. \$166 per square foot in 2014). Thus, EPS believes it is reasonable but perhaps aggressive to use the same \$215/SF figure for the HealthSouth building even if a portion may be used for commercial office functions or tenancies.

Applying the \$215/SF cost to the 87,774 square feet of the HealthSouth building, EPS estimates that the renovation and reuse of the building might cost roughly \$18.9 million. For this level of investment, EPS estimates that the HealthSouth building could offer roughly 54 residential units summing to 33,480 square feet of rentable space, plus another 10,000 square feet of potentially marketable commercial office space.

## **Estimated Reuse Revenues and Value**

To estimate the revenue that could be achieved by the HealthSouth building's conversion to a mixed-use building, EPS has applied currently prevailing market-rate and affordable residential rents, and the current going rate for Class B office space in Downtown Austin. EPS reviewed current asking rents for studios and one-bedroom apartments at several market-rate projects within a few blocks of the HealthSouth building, and determined that units around 620 square feet could achieve rents of roughly \$2.10 per square foot or \$1,302 per month. For the affordable units, a one-person household earning 60 percent of median family income would make \$34,200 per year and could afford rent at \$798 per month. Six current Class B office listings in Downtown Austin indicate that such space may command up to \$30 per square foot rents annually, though most listings were at least 10 percent lower.

### **Feasibility Conclusions with Major Reconfiguration**

The cost to convert the HealthSouth building into usable residential space is expected to greatly exceed the market value of such space, whether offered at market-rate prices or subject to affordability restrictions. **Figure 7** provides an illustration of the feasibility of reusing the HealthSouth building with reconfiguration as described above. In addition to the rehabilitation costs, the City paid \$6.5 million to acquire the buildings. As such, the total cost of acquisition and rehabilitation is estimated at \$25.4 million with major reconfiguration. When pro-rated over the expected uses inside the building, these costs work out to roughly \$360,000 per habitable unit and nearly \$600 per leasable commercial square foot.

**Figure 7** then estimates the rent that would be required to pay off the acquisition and rehab costs, plus cover standard operating expenses for the building. The \$25.4 cost of acquiring and reconfiguring the HealthSouth building might be funded with debt service payments of roughly \$1.8 million per year. In addition, EPS estimates that the operating costs for the reconfigured building would be roughly \$350,000 per year, bringing the annual cost per year to roughly \$2.2 million. As shown, EPS estimates that the residential units would need to achieve rents of roughly \$2,550 per month and the commercial space \$54 per square foot per year in order to "break even" on cashflow in the reconfiguration scenario. Each of these rates greatly exceeds the current market rate for such uses in this area of Downtown Austin.

Finally, EPS estimates the subsidies required for reusing the HealthSouth building based on currently applicable market-rate and affordable residential rents, and the current going rate for Class B office space in Downtown Austin. As shown, the achievable rent prices for all three potential uses fall well below those required to cover debt service and operating costs, and indicate that subsidies would be required. The total rents achievable for the residential units and commercial square footage is estimated at only \$980,000 per year, compared to an annual cost for debt service and operations at roughly \$2.2 million, leaving an annual cashflow deficit of \$1.2 million. Because this subsidy would be required every year, EPS has estimated the total subsidy required for the project by capitalizing the annual figure with a 5.5 percent capitalization rate, reflecting our expectation of how property cashflows are converted to building value. For each affordable unit, EPS estimates that a subsidy of \$380,000 would be required, and market-rate units are also expected to require subsidies of roughly \$270,000 per unit. The commercial space in the reconfiguration scenario likewise requires substantial subsidies of over \$400 per leasable square foot.

The result indicates that a total subsidy of \$22.1 million would be required for this project. This figure could be marginally improved if more of the units were offered at market-rate rents (EPS assumes half of the units would be affordable), but each market-rate unit also requires a substantial subsidy.

**Figure 7 Feasibility Profile WITH Major Reconfiguration**

Item	With Reconfiguration			Total
	Market-Rate 50% of Units	Affordable 50% of Units	Office	
<b>Costs of Acquisition and Rehab</b>				
Housing Units <sup>1</sup>	27	27		54
Leasable SF <sup>2</sup>	16,740	16,740	10,000	43,480
Property Acquisition Cost <sup>3</sup>	\$2,502,530	\$2,502,530	\$1,494,940	\$6,500,000
Total Rehab Cost (pro rata) <sup>4</sup>	\$7,265,580	\$7,265,580	\$4,340,251	\$18,871,410
Total Costs for Acquisition and Rehab	\$9,768,110	\$9,768,110	\$5,835,191	\$25,371,410
<b>Total Cost/Unit or SF</b>	<b>\$361,782</b>	<b>\$361,782</b>	<b>\$584</b>	
<b>Rent Required to Achieve Feasibility</b>				
Annual Debt Service (Acq. + Rehab) <sup>5</sup>	\$709,643	\$709,643	\$423,920	\$1,843,205
Operating Costs/SF/Year <sup>6</sup>	\$7	\$7	\$12	
Operating Costs/Year <sup>7</sup>	\$117,180	\$117,180	\$120,000	\$354,360
Total Costs/Year (Debt + Operating)	\$826,823	\$826,823	\$543,920	\$2,197,565
<b>Rent Required (FS) per unit or SF<sup>8</sup></b>	<b>\$2,552</b>	<b>\$2,552</b>	<b>\$54</b>	
<b>Feasibility at Current Rent Rates</b>				
Market Rent (FS) <sup>9</sup>	\$1,302		\$30	
Affordable Rent (FS) <sup>10</sup>		\$798		
Expected Rent/Year (FS) <sup>11</sup>	\$421,848	\$258,552	\$300,000	\$980,400
Total Costs/Year (Debt + Operating)	\$826,823	\$826,823	\$543,920	\$2,197,565
Net Operating Income/Year	(\$404,975)	(\$568,271)	(\$243,920)	(\$1,217,165)
Total Subsidy Required <sup>12</sup>	(\$7,363,173)	(\$10,332,191)	(\$4,434,914)	(\$22,130,279)
<b>Subsidy/Housing Unit</b>	<b>(\$272,710)</b>	<b>(\$382,674)</b>		<b>(\$327,692)</b>

- 1) EPS estimate of achievable units
- 2) EPS estimate of usable floor space
- 3) City purchase price for property
- 4) \$215/gross SF With Reconfiguration, \$183/gross SF X 50% of building Without Reconfiguration
- 5) 100% of costs at 6% interest amortized over 30 years
- 6) per leasable SF, estimated by EPS with adjustments for leasable vs. gross square footage
- 7) square footage X operating costs/SF
- 8) assumes 100% occupancy; total costs/number of units or square feet
- 9) \$2.10/SF for larger units, \$2.50/SF for small units, \$30 for Class B office; EPS market survey, June 2017
- 10) rent for 1-person HH at 60% AMI; assumes 28% of gross income toward rent
- 11) assumes 100% occupancy
- 12) annual subsidy capitalized at 5.5%

## Reuse Feasibility without Major Reconfiguration

### Reuse Potential

The Council Resolution sought information regarding the potential to provide housing "for individuals and families" while "maintaining the existing room configuration." In EPS's estimation, the current interior configuration of the floorplates in the HealthSouth building could yield 41 very small housing units, consistent with the number of inpatient rooms offered by HealthSouth (shown in **Figures 2 through 4**). Each such unit would be roughly 312 square feet, representing a studio or even "micro-unit" product type suitable for one person. These 41 small units would sum to less than 13,000 square feet of rentable residential space, representing less than 15 percent of the total 87,774 square feet of the HealthSouth building and less than 20 percent of the total space on any given floor. In EPS's opinion, this outcome would represent a highly inefficient use, as most newly constructed multifamily buildings lease at least 75 percent of their total floorspace.

While not impossible, it is not typical that commercial uses would share elevators, corridors, and other building features *on the same floor* as residential uses. If portions of the upper floors were to be offered for commercial office uses, at a minimum, significant changes would be required to separate these from the residential areas. Moreover, given the specialized uses of the various existing rooms in the HealthSouth building, significant interior reconfiguration likely would be required for most commercial uses, whether on the upper or lower floors. As such, EPS believes that it will be difficult to attract commercial users to share the HealthSouth building with housing in the scenario without interior reconfiguration.

### Estimated Reuse Costs

Without the major reconfiguration of interior walls, the creation of 41 very small residential units would still be very expensive. Only about 15 percent of the case study cost estimate was for "interior construction" to reconfigure walls; the remaining 85 percent was for items like plumbing, HVAC, electrical, interior finishes, and furnishings, plus design work and typical overhead and contingencies. EPS expects that the cost to create very small residential units would be higher per square foot than a larger unit, because the costs of standard features like kitchen appliances are spread over less square footage and the tighter space requires more thoughtful design and built-in fixtures and furnishings. As noted above, EPS does not believe that a commercial tenant could be attracted to the HealthSouth building without significant reconfiguration of the interior space. But even if only half of the HealthSouth building were to undergo the renovations required to yield the 41 small units (with the remainder of the building being "mothballed" at a nominal cost) *and* the renovation could be completed for 15 percent lower costs per square foot than the more significant reconfiguration (\$183 vs. \$215/square foot), EPS estimates the building's reuse would still cost \$8.0 million, and would yield only about 12,800 habitable square feet of residential space and no market-competitive commercial space.

### Estimated Reuse Revenues and Value

EPS reviewed current asking rents for studios and one-bedroom apartments at several market-rate projects within a few blocks of the HealthSouth building, and determined that units around 620 square feet could achieve rents of roughly \$2.10 per square foot per month, while smaller studio units might achieve rents nearer \$2.75 per square foot or \$858 per month for a 312-square foot unit. For the affordable units, a one-person household earning 60 percent of median family income would make \$34,200 per year and could afford rent at \$798 per month.

### **Feasibility Conclusions without Major Reconfiguration**

Even without major reconfiguration, the cost to convert the HealthSouth building into usable residential space is expected to greatly exceed the market value of such space, whether offered at market-rate prices or subject to affordability restrictions. **Figure 8** provides an illustration of the feasibility of reusing the HealthSouth building without reconfiguration.

The total cost of acquisition and rehabilitation is estimated at \$14.5 million without major reconfiguration. When pro-rated over the expected uses inside the building, these costs work out to roughly \$350,000 per habitable unit, nearly the same cost per unit as with major reconfiguration despite the fact that the units are roughly half the size in this scenario.

**Figure 8** then estimates the rent that would be required to pay off the acquisition and rehab costs, plus cover standard operating expenses for the building. The \$14.5 cost of acquiring and renovating the HealthSouth building might be funded with debt service payments of roughly \$1.1 million per year. In addition, EPS estimates that the operating costs for the reconfigured building would be roughly \$130,000 per year, bringing the annual cost per year to roughly \$1.2 million. As shown, EPS estimates that the residential units would need to achieve rents of roughly \$2,400 per month in order to "break even" on cashflow in this scenario. This rent rate greatly exceeds the current market rate for such uses in this area of Downtown Austin.

Finally, EPS estimates the subsidies required for reusing the HealthSouth building based on currently applicable market-rate and affordable residential rents in Downtown Austin. As shown, the achievable rent prices fall well below those required to cover debt service and operating costs, and indicate that subsidies would be required. The total rents achievable for the residential units is estimated at only \$400,000 per year, compared to an annual cost for debt service and operations at roughly \$1.2 million, leaving an annual cashflow deficit of \$775,000. Again converting this annual deficit to a total cost, EPS estimates that a subsidy of \$350,000 would be required for each affordable unit, and market-rate units are also expected to require subsidies of roughly \$340,000 per unit.

The result indicates that a total subsidy of \$14.1 million would be required for this project. Again, this figure could be marginally improved if more of the units were offered at market-rate rents (EPS assumes half of the units would be affordable), but each market-rate unit also requires a substantial subsidy.

**Figure 8 Feasibility Profile WITHOUT Major Reconfiguration**

Item	Without Reconfiguration			Total
	Market-Rate 50% of Units	Affordable 50% of Units	Office	
<b>Costs of Acquisition and Rehab</b>				
Housing Units <sup>1</sup>	21	20		41
Leasable SF <sup>2</sup>	6,552	6,240	-	12,792
Property Acquisition Cost <sup>3</sup>	\$3,329,268	\$3,170,732	\$0	\$6,500,000
Total Rehab Cost (pro rata) <sup>4</sup>	\$4,113,603	\$3,917,718	\$0	\$8,031,321
Total Costs for Acquisition and Rehab	\$7,442,872	\$7,088,449	\$0	\$14,531,321
<b>Total Cost/Unit or SF</b>	<b>\$354,422</b>	<b>\$354,422</b>	<b>\$0</b>	
<b>Rent Required to Achieve Feasibility</b>				
Annual Debt Service (Acq. + Rehab) <sup>5</sup>	\$540,717	\$514,968	\$0	\$1,055,685
Operating Costs/SF/Year <sup>6</sup>	\$10	\$10	\$0	
Operating Costs/Year <sup>7</sup>	\$65,520	\$62,400	\$0	\$127,920
Total Costs/Year (Debt + Operating)	\$606,237	\$577,368	\$0	\$1,183,605
<b>Rent Required (FS) per unit or SF<sup>8</sup></b>	<b>\$2,406</b>	<b>\$2,406</b>	<b>N/A</b>	
<b>Feasibility at Current Rent Rates</b>				
Market Rent (FS) <sup>9</sup>	\$858		\$30	
Affordable Rent (FS) <sup>10</sup>		\$798		
Expected Rent/Year (FS) <sup>11</sup>	\$216,216	\$191,520	\$0	\$407,736
Total Costs/Year (Debt + Operating)	\$606,237	\$577,368	\$0	\$1,183,605
Net Operating Income/Year	(\$390,021)	(\$385,848)	\$0	(\$775,869)
Total Subsidy Required <sup>12</sup>	(\$7,091,282)	(\$7,015,420)	\$0	(\$14,106,703)
<b>Subsidy/Housing Unit</b>	<b>(\$337,680)</b>	<b>(\$350,771)</b>		<b>(\$344,066)</b>

- 1) EPS estimate of achievable units
- 2) EPS estimate of usable floor space
- 3) City purchase price for property
- 4) \$215/gross SF With Reconfiguration, \$183/gross SF X 50% of building Without Reconfiguration
- 5) 100% of costs at 6% interest amortized over 30 years
- 6) per leasable SF, estimated by EPS with adjustments for leasable vs. gross square footage
- 7) square footage X operating costs/SF
- 8) assumes 100% occupancy; total costs/number of units or square feet
- 9) \$2.10/SF for larger units, \$2.50/SF for small units, \$30 for Class B office; EPS market survey, June 2017
- 10) rent for 1-person HH at 60% AMI; assumes 28% of gross income toward rent
- 11) assumes 100% occupancy
- 12) annual subsidy capitalized at 5.5%

## Opportunity Cost Assessment

As discussed above, the subsidy required to renovate the HealthSouth building for housing is estimated at roughly \$344,000 per unit without major reconfiguration of the building, and \$328,000 per unit with major reconfiguration. For these subsidies, the building could be converted to provide an estimated 41 to 54 affordable units, averaging between 300 and 620 square feet per unit. **Figure 9** replicates the subsidy per unit calculations from **Figures 7** and **8**, and adds an estimate of the subsidy per potential occupant based on the unit sizes.

**Figure 9 Estimated Subsidy per Occupant**

Item	WITH Reconfiguration	WITHOUT Reconfiguration
Units Provided	54	41
Average Size	620	312
Avg. Occupants/Unit <sup>1</sup>	1.5	1
Total Occupants	81	41
Residential Subsidy <sup>2</sup>	\$17,695,365	\$14,106,703
Subsidy/Unit	\$327,692	\$344,066
Subsidy/Occupant	\$218,461	\$344,066

1) EPS estimate based on unit square feet

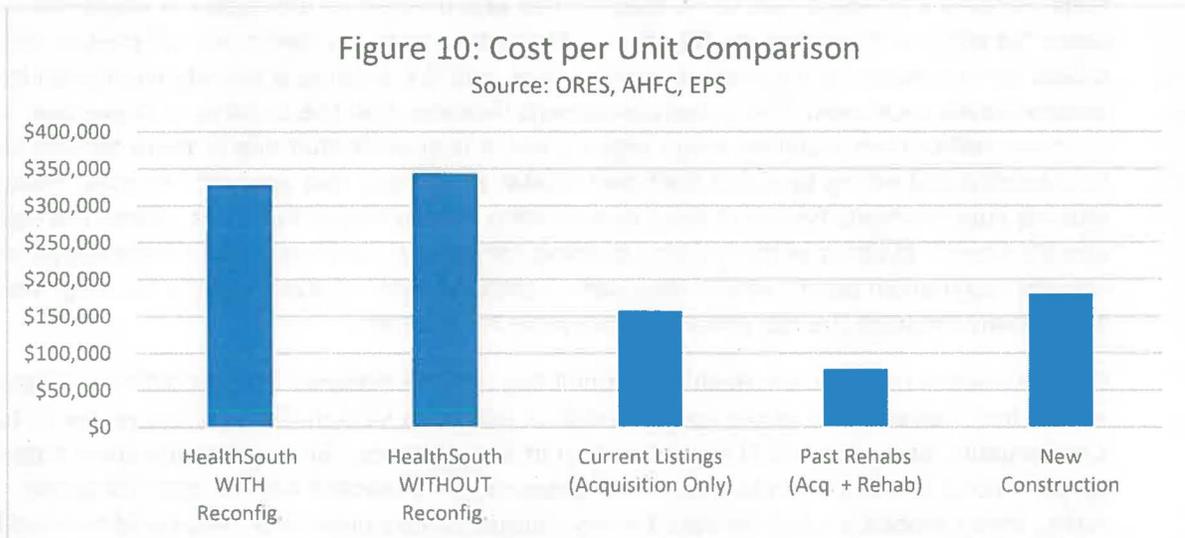
2) See Figures 7 and 8 for residential subsidies only

To place these costs into greater context, EPS has received information from Austin's Office of Real Estate Services (ORES), Neighborhood Housing & Community Development Department (NHCD), and Austin Housing Finance Corporation (AHFC) regarding other past and potential uses of funds for affordable housing. Information received pertains to:

1. **Current listings** – ORES provided list prices for 13 apartment properties being marketed for sale in the City of Austin, representing 202 total units at an average asking price of \$158,104 per unit
2. **Past Rehabs** – AHFC provided the costs to acquire and renovate three buildings in 2010-11, representing 350 total units at an average cost of \$79,000 per unit
3. **New Construction** – AHFC provided the budgets for nine new construction projects completed in 2016-17 or currently underway, representing 1,028 total units at an average development cost of \$180,847 per unit

Note that these figures above represent the gross cost to provide affordable units through these other means. The net cost would be lower, as the occupants would pay rents that cover a portion of the gross costs.

**Figure 10** compares the estimated subsidy requirements (net costs) for housing in the HealthSouth building to those other examples, and indicates that the cost to subsidize a housing unit at HealthSouth is significantly greater than the total costs recently incurred to acquire and rehab existing buildings for permanent affordable housing or to construct new affordable housing units. The HealthSouth costs also appear to greatly exceed the amounts required to acquire other currently listed existing apartments. For these much greater costs per unit, the HealthSouth building would provide very small units that would serve fewer people per unit than could be expected from other affordable housing projects.



For a given amount of funding sources, these comparisons indicate that the City could achieve at least twice as many affordable units, and serve more than twice as many individuals, by directing subsidies toward other projects as could be achieved at the HealthSouth building.

## Other Implementation Options

In addition to the potential renovation of the HealthSouth building for residential use analyzed above, EPS considers it reasonable that the City would explore three different paths for the property: 1) offering the building for sale; 2) seeking a low-cost interim use; 3) joining forces with Central Health to create a larger and stronger redevelopment site.

### Sale of the Building

The 2016 appraisal for the property indicates that the HealthSouth building is in an adequate state of repair and could command as much as \$33 million if offered for sale as a fee simple transaction, with the adjacent parking garage valued at another \$3.4 million. Medical-related uses may be able to make use of the combined properties largely as-is, and would benefit from the properties' proximity to the new medical school and hospital on the UT campus, as well as any improvements that may occur as a result of the redevelopment of the Central Health UMCB property immediately north of HealthSouth. The City could offer the properties for sale, and if their appraised value is achieved, would generate nearly \$30 million in net revenues after accounting for the \$6.5 million purchase price. This \$30 million gain could be used for numerous purposes, including the potential subsidy of affordable housing units elsewhere or even within the adjacent UMCB redevelopment. According to the City's [Affordable Housing Actions summary for 2015](#), the City approved direct investment of \$32.4 million into projects summing to 1,534 income-restricted units. These figures equate to an average City investment of \$21,148 per

unit. At this subsidy level, the net proceeds from the sale of the HealthSouth properties could conceivably be used to create roughly 1,500 affordable units, rather than the City having to identify and secure an estimated \$22 million in currently unidentified subsidy to reconfigure and reuse the HealthSouth building for roughly 54 small affordable units.

### **Interim Use Potential**

As described above, the HealthSouth building appears to face significant feasibility challenges if long-term reuse as residential space is sought. However, as indicated in the appraisal valuation, there remains a prospect that some specific user group would be interested in occupying the space "as is" or with modest modifications. The proximity to the Seton and UT medical complex should remain attractive for medical-related uses, and the building is already configured to accommodate such uses. The initial assessment indicates that the building is in average condition rather than requiring major repairs, and it is possible that one or more tenants could be attracted and willing to invest their own capital and/or pay rent adequate to cover modest internal improvements typical of most re-tenanting of commercial buildings. Given the mission-specific interior buildout of the existing building for medical functions, EPS believes any non-medical commercial tenant would likely seek significant reconfiguration of the building, which would likely diminish the net proceeds achievable for the City.

Current market rates for the HealthSouth building may be between \$20 and \$30 per building square foot (full service), which could yield \$1.8 million to \$2.6 million in gross proceeds to the City annually, or perhaps \$1.0 to \$2.0 million in net revenues. Such payments could support a revenue bond of \$15 million to \$30 million (assuming 4.5 percent interest over 25 years). Again, these proceeds could be used for any number of City objectives, and could be used to create many more affordable housing units than could be achieved in the HealthSouth building.

### **Redevelopment Potential**

Central Health has identified four "shortlisted" development entities who are being invited to make formal proposals for the redevelopment of the UMCB campus immediately north of HealthSouth. This six-block area offers a unique opportunity for coordinated development in Downtown Austin near UT and the Capitol Complex. The 2016 appraisals for the HealthSouth properties indicated that they may be worth an estimated \$15.4 million as a site for development. If the City elected to coordinate with Central Health on the creation of a unified district by combining the HealthSouth properties with those offered by Central Health, the \$15.4 million value of the land could conceivably be used to enhance the overall UMCB redevelopment project through community benefits and/or more efficient development, or the City could simply retain the land value proceeds for other City objectives.

### **Conclusions**

Based on this analysis, EPS concludes that the reuse of the HealthSouth building for residential use is likely to require substantial subsidy that greatly exceeds the amounts that would likely be required to acquire and renovate other existing properties for affordable housing, or to construct new affordable housing on other sites in the City. By contrast, the value of the HealthSouth property if sold or leased for another occupant (particularly one who could make extensive use of the existing interior configuration), or if simply used as a site for future development, is likely to generate significant positive revenues that could be used for more efficient affordable housing development or other City objectives. EPS recommends exploring these alternative options, including outreach to commercial brokers, direct contacts with potential users, and discussions with Central Health regarding the potential benefits of coordinated disposition and development.